RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Oct. 14, 1992 **LETTER 1106**

THE MARKET PICTURE: On Monday, Oct. 5, the D-J Industrial Average closed below its **3181.35** April 8 low. This action confirmed the previous bearish indications of the Transportation Average. Taken together, the two D-J Averages have signaled the existence of a primary bear market under Dow Theory.

When did the bear market start? According to Dow Theory, a bear market begins at the point where the two D-J Averages recorded their last joint highs. That point was February 20, at which time the D-J Transportation Average struck a closing high of 1467.68. Although the Dow pushed higher, hitting its peak of 3413.21 on June 1 -- the date of February 20 stands as the point where the bear market began.

With the primary trend of the market bearish, the question asked is, "How far and how long?" It's a good question, and unfortunately, the answer is rather unsatisfactory. **According to Dow Theory, "Neither the duration nor the extent of a primary movement can be predicted in advance."** In other words, there's absolutely no way of forecasting how far a bear market will carry or how long it will last. As a rough rule, the bigger the preceding bull market, the bigger the bear market. We've experienced a very big bull market.

I'm getting a flood of questions about the **Primary Trend Index (PTI).** As this is written (see page 2 chart), the PTI has NOT yet confirmed the bearish indications of the Averages. (See Late Notes on page 6.) However, this is the way I interpret the situation. The D-J Averages have given a bear signal, and I believe the signal is valid. But stock market action is still tentative; the market has not yet moved into its true bear phase. This phase will be signaled when the PTI declines on a trend basis, first breaking its 89-day moving average, then heading persistently south.

When might that happen? I would expect fairly soon, but the market marches to its own tune, and the bear will emerge full blown when he's ready, and only when he's ready.

Note: I have heard rumors to the effect that the government (the Fed?) manipulated the market during the amazing "bungee" decline of October 5, a decline that took the Dow down 103 points, then back to where it ended the day off 21 points. Of course, the last thing in the world the Bush administration wants is a stock market collapse just weeks before the election. Could the market have been manipulated? Who knows? I'm sure I don't, but it's a thought.

However, manipulation makes little difference in the big picture. The bear will do what he has to do -- when he wants to, in his own good time. Bear markets don't run by schedules, and they aren't reversed by news events or manipulations. The bear will have his way. He's got the power.

The Dow is now well below its 200-day moving average as are the S&P 500, the Amex and the NASDAQ. The *Investor's Business Daily* Mutual Fund Index (20 leading mutual funds) is also below both its 50-day and 200-day moving averages, so the mutual funds are sharing in the downside pressure.

My old friend, Joe Granville, has insisted all along that the bear market started in January. Joe adds in his latest report that "whatever it takes to put this market down will take place." Which is another way of saying that "news goes with the trend." How so?

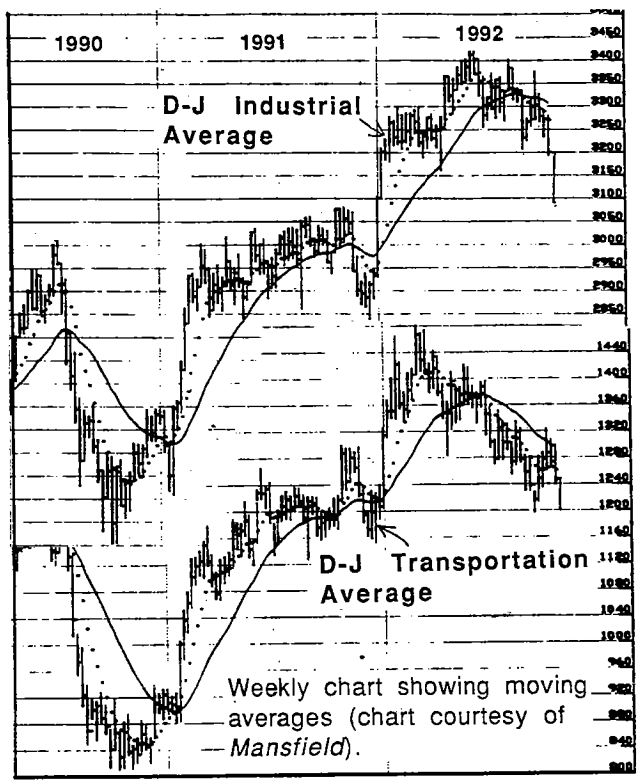
Oct. 2 DJIA 3200.61; PTI 3559; A-D Ratio -10.34
Oct. 9 DJIA 3136.58; PTI 3541; A-D Ratio -10.91
Dow Yield: 3.31%; Dow Price/Earnings: 54.4
Dow 200-day MA: 3293; Dow 30-day MA: 3272
Dow Times Book Value: 2.40; PTI 89-day MA: 3534
Percentage of Undervalued Blue-chips: 10%

The same news that would be taken bullishly in a bull market will be taken bearishly in a bear market. It's remarkable, but that's the way Wall Street works.

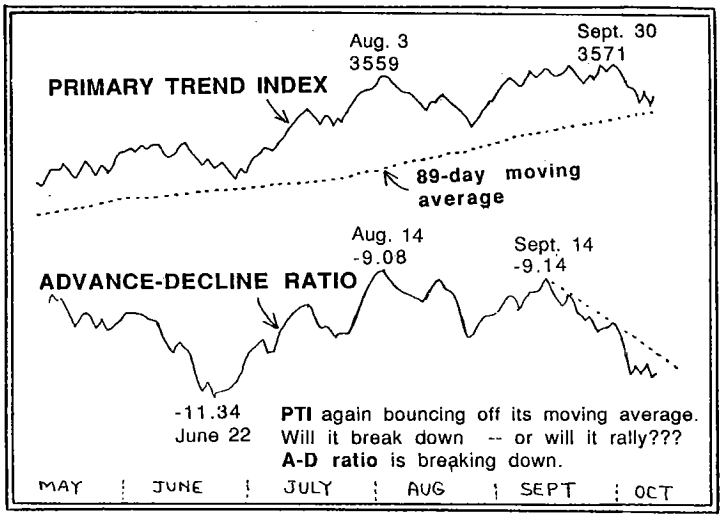
Given that this is a bear market, I am asked, "What are the fundamentals of the situation?" Frankly the fundamentals comprise a very long list. The big fundamental, to my mind, is the federal deficit. It's the monster that is eating this nation alive. I've written so much about the deficit that I almost feel embarrassed to bring it up again. But the federal deficit is a huge problem. And it's a problem that offers no painless solutions.

To eliminate the deficit would entail massive sacrifices on the part of the American people. To even begin to shrink the deficit would probably be beyond the will of Washington (we should know more about Washington's will shortly). One thought on this -- if this recession grows more severe (and I believe it may), tax returns (both individual and corporate) will shrink, creating a thoroughly disastrous deficit for 1993.

Another problem for the market is the election itself. With a bear market already in progress and with the nation in recession, the odds on Mr. Clinton being our next president become almost overwhelming. President Clinton -- it's a concept that scares the hell out of most thinking businessmen. Mr. Clinton has already announced that he will tax and "invest," which, of course, is his euphemism for "tax and spend."



Weekly chart showing moving averages (chart courtesy of *Mansfield*).



Since over-taxing and over-spending are the processes that have placed the US in its current painful position, the idea of more of the same is anathema to businessmen and investors. But Mr. Bush is held in such low esteem by the general public that he is almost sure to be packing his suitcases before November is out. It's not that the nation loves Bill Clinton, it's simply that they've had their fill of George Bush.

So at this point, as I see it, the picture is that of a market feeding on itself. It's a market that's sinking partly because of a perceived Clinton victory. But ironically, the worse the stock market action, the better the odds that Clinton will be our next president.

The old adage states, "The market always does what it has to -- but never when." Thus this market held up under the stimulation of 24 separate acts by the Fed to lower interest rates. But lower interest rates couldn't help an economy that was choking on too much debt -- good debt, bad debt, fair debt and more debt. Banks wouldn't lend (they didn't have to, they bought Treasury bonds), consumers wouldn't borrow (they were too worried about pink slips), and the Fed with all its manipulations couldn't "jump start" the sick economy.

In all fairness, the bear market isn't just an American phenomenon. We're all part of the new global economy, and consequently, the bear market is global. Markets across the face of the earth have been beaten down, and regardless of whether you're British or Japanese or Danish or German, you've been watching your favorite investment coming back to earth. In fact, I've been talking for months about how awful the world stock markets are looking. The US market (held up by its low, low interest rates) has simply been a late arrival to the game.

ADDITIONAL COMMENTS: No two bull or bear markets are alike. Each one has its tricks and its deceptions. For instance, in the bear market of 1929-32, the dreadful fooler was how low the market was ultimately fated to go (it ultimately lost 90% of its peak value). In the 1937-42 bear market the deception was the unbelievably puzzling period of 1938-42, a period which saw a series of mini-bull and bear moves, ending with the famous and crushing 1942 low of 92.92.

The 1946-49 bear market was outstanding for the pessimism it generated. I remember (yeah, I was there) that we were all waiting anxiously for the "Great Post-War Depression" that was sure to follow World War II. It was a depression than never arrived. But the fear was there, and many stocks were slaughtered, including Kaiser-Fraser ("the next GM") which I owned.

The 1966 to '74 bear market was outstanding for its damnable longevity and its series of deceptive surges to unconfirmed highs on the part of first one average and then the other. Each surge was followed by a collapse, until finally the collapse of 1973-74 put a climactic end to this vicious bear market.

So what I'm trying to tell you is that there's absolutely no way (unfortunately) of predicting what the bear has in mind. He can be mild, he can be vicious, he can be straight forward (don't bet on this one), and he can be deceptive.

Remember -- just as the bull wants to take the market as high as he can with as few investors aboard as possible, the bear wants to take the market as far down as he can, with as many investors aboard as possible. Can the bear be that mean, that despicable? You bet he can --and he will.

As of now, a lot of damage has been done to a great many stocks, and the question is -- "Should I sell, should I sit, or what should I do?" This is the toughest question an advisor has to face. In a primary bull market when you're late to buy, it doesn't cost you. It simply means that you're going to get a little less of the bull market pie. However, in a big bear market when you're late to sell, it's going to cost you. It's going to play hell with your bank account.

Of course, the one thing every advisor is afraid of is telling his people, "Sell everything, run for the hills," and then a few days later the market embarks on an extended advance ("Oh no, my subscribers will hate me!").

So I simply say this: in my opinion you have to have an investment policy. And it shouldn't be a policy that changes with the wind. My policy is to be invested in stocks early in a primary bull market and to be out of stocks in a primary bear market. If I'm whip-sawed in the process, well, that's life -- that's just part of the game. After all, if there were never any whip-saws, if there was never any confusion, we'd all be rich. It's the market's whip-saw, it's the deceptions, it's the uncertainty that makes Wall Street the toughest game in the world.

When investing in a bull market or devesting in a bear market I always keep one thought in mind -- bull markets tend to go higher than anyone thinks possible. And bear markets tend to go lower than anyone thinks possible.

Here's something else -- I don't think there's anyone who has written more about the big debt problem, the bearish implications of the deficits, than I have. So if you want to state the case for a potentially whopping bear market all you have to do is re-read the last Letter.

I think the market is overpriced, way overpriced. The Dow price/earnings ratio is far too high, Dow dividends are not nearly covered by earnings, and the Dow is selling at double its book value. Finally, earlier this year the yield on the Dow sank to a minuscule 2.7%. Bear markets have always followed that kind of extreme overvaluation. The bear market action doesn't have to materialize immediately. The facts are, however, that we've had a long period of overvaluation and a long period of debt-building. I don't think a six-month bear market is going to correct the situation.

I'll repeat again something I've said many times before. "In a bear market, the person who loses the least is the winner." Don't bet on "beating the bear," because the odds are heavily in favor of your sustaining some kind of losses. If your assets are denominated in dollars (which I'm sure most of your assets are), you're going to lose in international purchasing power. If you own a house, you've already already seen its value decline. If you own a portfolio of stocks, you've almost surely seen its value shrink. If you own bonds, you're probably ahead now, but again your bonds are probably denominated in dollars so on a global accounting basis the bonds haven't been that great.

But it's OK. We expect to be poorer in a bear market. The trick is to do as well as we can, to lose as little as we can, to survive as best we can. The gravy (and don't forget this) is to keep it together as well as possible until the bear market bottom. When the bottom arrives (remember 1974, you veteran subscribers?), we load up on good dividend paying stocks and it gets better. That's the sunny side of the situation.

Here's something to keep in mind, particularly during bear markets: You'll notice that a large majority of the commentators (in all media) are analysts from banks, corporations and brokerage houses. These people feel pressure to be constructive, to be bullish. It has to do with saving their jobs. Newspapers don't like gloom and doom stories peppering their pages (it hurts advertising and circulation), and the same goes for the broadcasters. Brokerage houses certainly don't want a torrent of bearish news and forecasts (it kills volume). And besides, it's human nature to be positive, to be hopeful.

"Hope springs eternal," runs the old adage, and it's a wonderful adage -- except that it's a very costly adage during the course of a primary bear market.

An interesting sidelight to the current situation. *Lowry's* [(407) 842-3514] puts out a report that I've been taking for around 20 years. This excellent report is based on buying power and selling pressure in the market, but in their recent issue *Lowry's* notes that there are a growing number of stocks on the NYSE that really aren't regular "operating companies." These stocks include a large number of preferred stocks, and closed-end bond funds, stocks that reflect debt rather than equity. Add to this the interest-rate sensitive stocks and you have a great number of stocks that give the indices (particularly the advance-decline ratio) a bias towards strength that is not warranted.

Lowry's runs an advance-decline line of just the "operating companies" stocks. Last week this index dropped to a two-year low, its lowest level since the 1990 low.

DOLLARS: With the US in a prolonged recession, with an endless parade of record deficits, with an election coming up and a tax-and-spender (Clinton, who else) favored to win, it's amazing that the dollar has not sunk completely out of sight (of course, it has recently dropped to record lows against both the Swiss franc and the yen).

All of which demonstrates the advantage of having a reserve currency. A reserve currency (the dollar) is used for transactions all over the world. Furthermore, the dollar, as a reserve currency, is held by every central bank as part of its reserves. So there's a heavy built-in demand for dollars that would not exist if the dollar was not a reserve currency. Let me put it another way -- if the dollar was not the world's reserve currency, if the dollar was "just another currency," then in view of the US' financial condition and its politics the dollar would probably be worth half of what it is today.

On October 1 Helmut Schlesinger, head of the Bundesbank, revealed that since the beginning of September the bank has spent the staggering amount of $63 billion attempting to support other currencies. Since this amount will tend to boom the German M-3 money supply (probably to double digits), there will be resistance by the Bundesbank to lowering rates. Furthermore, no one can, in all honesty, accuse the Bundesbank of "throwing a monkey wrench" into the world's currency markets. Spending over $63 billion to hold up other currencies is an incredible act. But in the end, the fundamental forces were even more powerful than the German central bank. And the pound, the lira and the peseta were knocked down.

INVESTMENT POSITION: With the Averages signaling a bear market but with the PTI still slightly above its 89-day moving average, one subscriber suggests that instead of a bear, I put a steer in the box -- a castrated bull. Nope, the bull is out and the bear is in. Say hello to bruin.

Subscribers who bought the Benham European Government Bond Fund [(800) 321-8321)] have been on a roller coaster ride, but with the fund back in about the center of its recent range and paying over 8%, it's worth holding. It's been a scary ride but these are scary days. I still like the fund.

I have also been recommending the German long bond (ten years out). This bond bottomed in August and has been moving up ever since. Of course, you have a double feature here; the first feature is the trend of German interest rates (which remain high), and the second is the trend of the D-mark (which has been all over the place).

However, the German stock market has been hit hard (down over 40%), and German business has also been hit hard. These two militate towards lower German rates, so you really don't know what the Bundesbank will do next. Russell guess: They'll sit tight with today's high rates, at least for a while or until the next German M-3 figures come out.

At any rate, I like the German bonds (bunds); they offer decent rates of return plus diversification OUT of dollars.

As for stocks, I don't think they will be the place to be for a while, maybe quite a while. Over the past few years the public has loaded up with vast quantities of stocks and bonds. The buying has been mainly through mutual funds. Already, many of these funds are registering losses for the buyers. The bear will do what he has to -- to part the public from its mutual funds -- but it will take time, probably a good deal of time.

NOTES & QUOTES: I'll admit it; I was a Perot rooter in the beginning. When he quit the race, I turned off on him. Then when Perot "summoned" the Bush and Clinton boys to his headquarters, I thought it a bit weird (who the hell is Perot? -- Perot should have come to them). And when Perot started his "if my fans love me and want me, I'll consider running" thing, I got nauseous. Now I can't even bear to listen to him. Sure, his insistence on eliminating the budget is correct. But as for Perot himself, he's evasive, irritating, an egotist, and he's off my list. At this point, the only surprise is that anyone can stand to listen to him.

Budget Deficit
ITS MASSIVE SIZE BOGGLES THE MIND, ITS GROWING DAILY AND THE AMERICAN PEOPLE HAVE BEEN HELD HOSTAGE TO IT.
Ross
Budget Deficit
BUT ENOUGH ABOUT MY EGO, LET'S DISCUSS THE BUDGET DEFICIT...
Ross
MIKE THOMPSON

Mike Thompson, State Journal Register, Springfield, Ill., Cooley News Service

* * *

The polls would have us believe that Clinton is going to be our next president. I won't argue with that. In "Economic Viewpoint" (*Business Week*, Oct. 5), Paul Craig Roberts presents one version of what might happen on a Clinton Victory: *"Clinton sweeps in with his stable of eccentric economic advisors, including his old Oxford University buddy, Derek N. Shearer, now professor of public policy at Occidental College in LA -- who has apparently slept through the 20th century -- and produces a rerun in the US of France's disastrous experience with socialism a decade ago. Shearer thunders against the capital markets and Professor Robert Reich of Harvard attempts to dismantle the autonomy of corporations with industrial policy. The dollar dies, capital flies, and long-term interest rates go through the roof. With the world monetary system at stake, the Group of Seven industrialized countries forces a shaken and chastened Clinton to jettison his advisors and take on new, more sensible ones. Within 90 days the experiment is all over. And just as France following President Mitterand's retreat, no American ever mentions socialism or 'economic democracy' (Shearer's euphemism) again.*

"This possibility has a lot going for it because it is the best way for the US to catch up with the rest of the world and to get socialism out of its blood forever. It is extraordinary that Clinton has advisors who are determined to socialize America, while the rest of the world is trying to escape from the socialist ashes of the 20th century."

* *

Here's the latest from the *Sindlinger* polling organization [(215) 565-0247]: "With only five weeks until the election, the consumer's pocketbook has not been smaller since the Great Depression. Household liquidity had dropped sharply for the fourth week in a row, tieing its recession low of the July 25 week. Our current income notched higher, but the number of households reporting lower income rose to the highest level in our 38 years of daily surveying, and to a level not seen since the depression decade of the 1930s." *Sindlinger* puts the true unemployment rate at 10.5%. Russell comment: *Sindlinger* has been extremely accurate regarding economic trends, unlike the vast majority of economists (remember, first they said there would be no recession, then they said the recession would be short and mild, and most recently they seem to have lapsed into a state of subdued confusion).

* *

A new *Washington Post* study states that the banking crisis is far from over and that 1,000 US banks are "on the brink." The cost of closing these insolvent banks will run from $45 billion to as much as $95 billion, depending on how fast the regulators shut them down. The $95 billion figure is twice as high as FDIC projections.

* *

For the second quarter the Japanese economy registered zero growth. This is its worst performance in 20 years. Nevertheless, the Japanese trade balance continues hugely favorable, and the Japanese yen on September 28 rose to a record high against the dollar. Japanese authorities insist that the second quarter decline will mark the bottom of the recession for Japan, and that the new $86 billion government spending program will turn the tide. We'll see.

Japan's current account was up again in August, the 17th consecutive increase. In the first seven months of 1992 the Japanese trade balance widened to an incredible $131 billion on an annualized basis (up from $93 billion for the same period last year). That puts upward pressure on the yen. And a higher yen worries Japanese exporters, since it means that Japanese products become increasingly expensive, which in turn puts pressure on Japanese profit margins.

* *

NBC and CBS entered the 1992 football season with a record amount of ad time unsold (30% to be exact). As a result, they were offering discounts of as much as 17% for NFL advertising.

Meanwhile, the top 100 national advertisers in the US dropped their spending by 3.9% last year. This is the biggest decline in advertising in the 37 years that records have been kept, according to the magazine *Advertising Age*.

* *

As the world changes: Of the world's 25 largest banks, 16 are Japanese, 4 are French, 2 are British, one is Dutch, one is Hong Kong, none are American. The 26th largest bank is the shaky Citicorp.

* *

What the Germans are trying to do in East Germany is unprecedented in history. Germany has taken in the junky East German mark and traded it for the powerful D-mark on a one-for-one basis. By one estimate, West Germany will have transferred some $250 billion to the East by the end of this year. This has resulted in a German federal deficit of approximately $100 billion. With the big deficit and the creation of a large quantity of new money, the German inflation rate has risen to 4% and the money supply has grown at a 9% rate. To fight the inflationary results, the Bundesbank has raised interest rates to above 9%, and this in turn has slowed German economic growth to 2%. It has also squeezed corporate cash flows by reducing the mark value of foreign earnings of German firms. That in turn has hit the German stock market hard. However, much of the transfer of German money has gone to clean up and build up East Germany. If the union proves successful (and it look as though it will), Germany will emerge as the undisputed economic powerhouse of Europe.

* *

Sign of the times: last week giant Dow Chemical announced that henceforth all its European transactions would be in D-marks. Russell comment: Increasingly, I feel, the D-mark will be cutting in on the dollar as the world's reserve currency. Ultimately (see last Letter), if current policies are followed, I feel the dollar is doomed.

* *

Squeezed by the world recession, Rolls Royce is laying off 30% of its work force. Sales of the cars has fallen off a whopping 65% over the last 18 months. Porsche, no longer the favorite of the "speed jockeys," just fired its president and is cutting down on its work staff.

* *

Quote of the Week (by Bob Green, syndicated columnist for the *Chicago Tribune*): "I grew up thinking of California as the dream at the end of the rainbow, to use a cliche. It was the place where people got rich quick and went to the beach every day. With the dream gone, there's nothing to replace it. What do we dream about now? Arkansas?"

Second Quote of the Week: "It is amusing to hear US officials posturing that a lower dollar boosts exports. Cutting prices, everything else being equal, does increase sales activity. That is helpful in the short term for employment, etc. However, longer term it lowers the net worth of the region and enables foreigners to buy US assets for less money. In other words, a lower dollar lowers the net worth of the US on the global stage and makes us a poorer nation -- and our leaders are working hard to make it happen" (from *Individual Investor Trim Tabs*, PO Box 2949, Santa Rosa, CA 95405).

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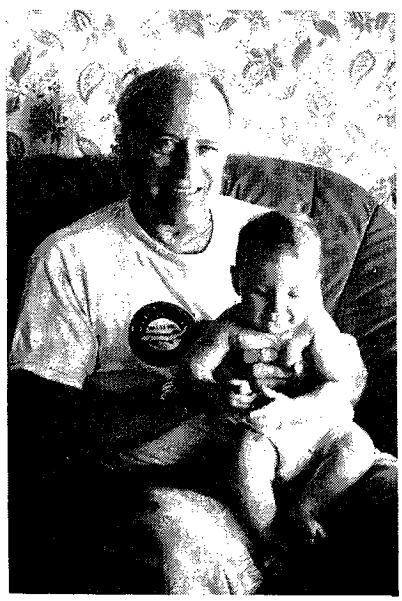


Human Interest Dept. Just call me gramps. Yep, it's hard for me to believe, but I'm a grandpa twice over (daughter Daria Doering) and third daughter Betsy's got another one cooking in the hopper. My fourth daughter, Lauren, is only 11, so no babies there for a while. Here I am with young Jake Doering, age five months. Jake is very good-natured and usually very moist. Gad, I wonder if I've forgotten how to change a diaper? But nah, face it, changing a diaper is like riding a bike, once you've done it you never forget how.

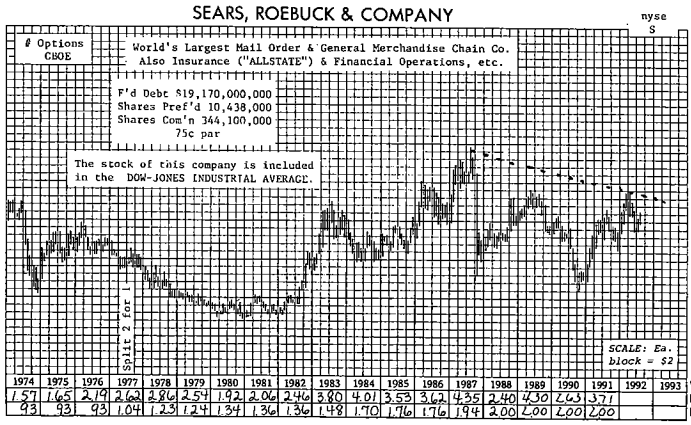
* *

Purchasing power parity, it's a concept that has always fascinated currency mavens. Here are some comparisons of what a basket of goods valued at $100 would cost in various other nations. Britain $112; Germany $128; Japan $156; Sweden $170. McDonald's Big Mac hamburgers are now almost an international item (like diamonds or Rolex watches). Here's what a Big Mac costs in various nations: US $2.19; Mexico $2.25; Japan $3.09; Switzerland $3.86. A paperback book that costs $5.71 in the US costs $8.75 in Germany, $8.82 in Japan, and $11.47 in Italy. Levi jeans that cost $30 in the US cost $77 in Italy, $80 in France and $81 in Britain. Get the idea? The dollar buys a lot in the US and the hard currencies buy very much more.

In fact, the *NY Times* headlined it, "Weak Dollar Makes US World's Bargain Bazaar." It continues, "To the Swiss businessman just off the Concorde, the $120 tab for a room at the Plaza looks

like the lunch check back home. To the teenager from Paris, the $9 sticker on the tape at Tower Records and the $30 tag on a pair of Levi 501s read like big signs that say, buy one, get one free." No doubt about it, the US with its weak dollar has become the bargain basement of the world, and if you're a German or a Swissman or a Frenchman you can come here and shop till you drop -- and not even feel the pain.

BELLWETHERS: Two weeks ago Sears announced that it would spin off almost all its non-retail divisions. Ironically, many analysts have felt that Sears should keep the non-retail and get rid of the retail. The fact is that Sears retail operation is not the lowest priced in the field, nor has Sears been able to compete in higher fashion. In 1991 Sears' total sales were $57.2 billion, of which $31.4 billion was merchandise and the rest was insurance, real estate and brokerage. From 1910 to 1970 Sears stock was a winner, making dozens of millionaires out of Sears employees who accumulated the stock. As late as 1947 Sears stock sold for an adjusted price of 2 1/2. In 1973 Sears topped out at 61. It has never been back. Analysts figure Sears has about five years to prove it can compete successfully in the retail merchandising area. After that, mmm.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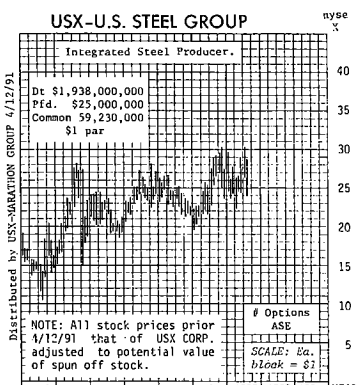
When I first started watching the markets (1945) the word was, "As steel goes, so goes the market." They were talking about US Steel although I guess you could have added Bethlehem Steel. Steel in those days was the barometer of industrial production. I'll never forget at the beginning of the great 1957-66 bull market the way steels painted the Board. Huge gobs of US and Bessie (BS) went by, 5,000, 10,000, 50,000 share lots, in a breathtaking steel parade. When that happened, we all knew that the bull had come roaring out of his stall.

In 1960 one of my subscribers was the nation's top analyst for the steel industry (he was with *Wainright Co.*). I remember that he told me, "Russell, the American steel industry is losing out to foreigners. You'll never again see these prices for America's big steel companies." At that time US Steel was just under 80. It topped out in a huge "head-and-shoulders" formation. By late-1971 "Big Steel" was down to 17. My analyst friend was right, the US steel industry never regained its former glory.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NOTE: All stock prices prior 1/12/91 that of USX CORP. adjusted to potential value of spun off stock.
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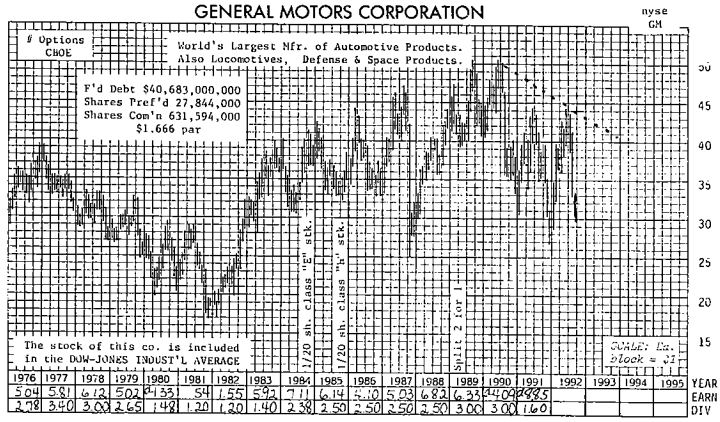
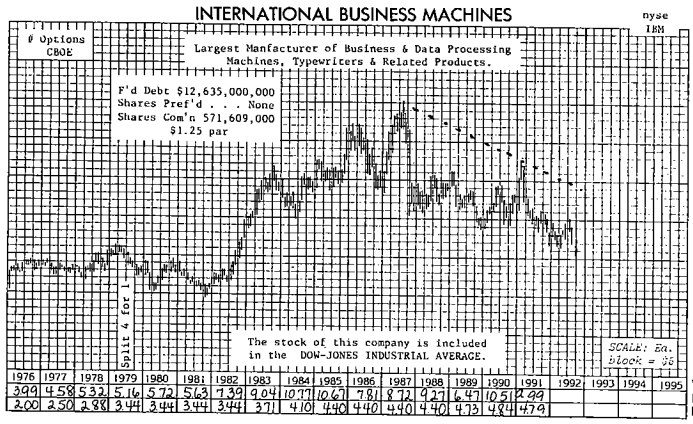
After that it was the big auto stocks. "What's good for GM is good for America," they said, and GM was the bellwether of the NYSE. GM at the peak of its power hit a high of 112 in 1965. At the bottom of the 1966-74 bear market GM sank to a low of 29. As this is written, GM appears to be in trouble again (it's losing almost $300 million a month on its N. American operations).


GENERAL MOTORS CORPORATION
nyse GM
Options CBOE
World's Largest Mfr. of Automotive Products.
Also Locomotives, Defense & Space Products.
F'd Debt $40,683,000,000
Shares Pref'd 27,844,000
Shares Com'n 631,594,000
$1.666 par
The stock of this co. is included in the DOW-JONES INDUST'L AVERAGE
1/20 sh. class "e" stk.
1/20 sh. class "h" stk.
Split 2 for 1
SCALE: Ea. block = $5
1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995
YEAR
EARN 5.04 5.81 6.12 5.02 4.33 .54 1.55 5.92 7.11 6.14 5.10 5.03 6.83 6.33 4.40 4.85
DIV 2.78 3.40 3.00 2.65 1.48 1.20 1.20 1.40 2.38 2.50 2.50 2.50 2.50 3.00 3.00 1.60

Next came IBM. Analysts saw IBM as the new bellwether. Market bulls complained that "Big Blue" should have been in the D-J Industrial Average all along, and they further argued that the Dow was misleadingly low because IBM had been left out. IBM had been a spectacular performer. From a low (adjusting for splits) of under 1 in 1947, IBM climbed to a high of 176 in 1987. A few years later Dow Jones obligingly put IBM in the Dow. Alas, following its 1987 peak, IBM went into a vicious bear market, and last week IBM slumped to as low as 76 1/2, down 56% from its high. At 76 1/2, IBM was at its lowest price level since 1982, just another casualty in a long line of Wall Street's "bellwethers."


INTERNATIONAL BUSINESS MACHINES
nyse IBM
Options CBOE
Largest Manfacturer of Business & Data Processing Machines, Typewriters & Related Products.
F'd Debt $12,635,000,000
Shares Pref'd . . . None
Shares Com'n 571,609,000
$1.25 par
Split 4 for 1
The stock of this company is included in the DOW-JONES INDUSTRIAL AVERAGE.
SCALE: Ea. block = $25
1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995
YEAR
EARN 3.99 4.58 5.32 5.16 5.72 5.63 7.39 9.04 10.77 10.67 7.81 8.72 9.27 6.47 10.51 9.99
DIV 2.00 2.50 2.88 3.44 3.44 3.44 3.44 3.71 4.10 4.40 4.40 4.40 4.40 4.73 4.84 4.79

By the way, most people seem to think that the word bellwether has something to do with the trend of the weather. Not so, the bellwether is the lead-sheep in the flock. It was the sheep that had the bell around its neck, and where the "bell wearer" went, the rest of the flock followed.

Note: A few weeks ago *Barron's* published an article on FAS 106, the accounting rule that covers employees' post-retirement benefits. Next year many corporations will be adopting the accounting rule. GM estimates the one-time transition to FAS 106 will cost the company $16 to $24 billion or $23 to $24 a share. If this huge charge is amortized over 20 years, it could reduce earnings by as much as (are you ready for this?) $4 a share. And this is just one company! (Charts courtesy of *M.C. Horsey & Co.*, Salisbury, MD 21801).

BOOK: My friend, Mike Paulenoff, together with Stanley Kroll, has written one of the best and most informative books on futures that I have seen (and I've seen a lot of them). In fact, I'd call this book the "Bible of the Futures Market." It's just a superb work -- invaluable for anyone who wants to know the history of the futures markets, how they work, and how to work with them. The book is called, "The Business One Irwin Guide to the Futures Market," published by Business One Irwin, and available in bookstores.

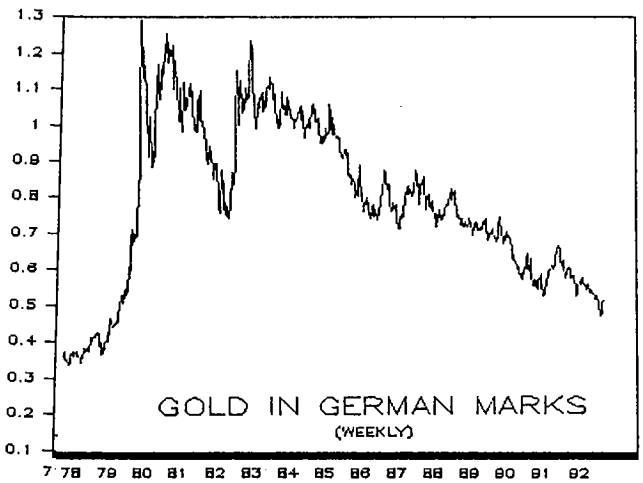
GOLD, MONEY, POLITICS: The problem or danger in a world of floating currencies is becoming apparent. The dollar is now the world's reserve currency, the "money" against which all

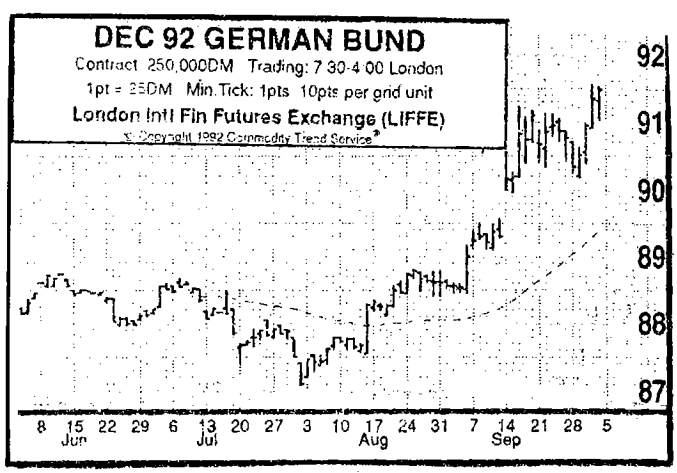
other currencies are measured. But what's a dollar worth? No one knows, because the dollar is a fiat currency, it's not attached to anything intrinsic, it floats on thin air. So the dollar's worth can only be judged against the mark's worth or the franc's worth or the yen's worth. The dollar is basically a medium of exchange. Why? Because the US government states that "this note is legal tender for all debts, public and private." Actually, the original dollar was described in terms of a specified quantity of gold. Since today's post-Bretton Woods "dollar" does not fit the original definition of a dollar, technically, it is NOT a dollar, it is simply a note.

Without a gold anchor, currencies can swing wildly in either direction, which is exactly what they've been doing. For instance, at its 1985 high the dollar was hugely overvalued. Then the dollar came down, and by 1992 it had lost half its value against a basket of other major currencies.

The worst part of the floating currency situation is that all currencies over time can lose purchasing power, and, of course, that's exactly what's been happening. It's simply that different currencies lose purchasing power at different rates of speed.

Two currencies that have stood up strongly since 1981 are the Swiss franc and the German mark. The first chart (courtesy of *Mainstreet Alliance,* 4457 Willow Rd., Pleasanton, CA 94588) shows gold (weekly) in terms of D-marks. With a no-nonsense Bundesbank in charge of German money, the mark has acted superbly both as a medium of exchange and as a store of value. Which is one reason why I have recommended German bonds (bunds) for subscribers. The second chart (courtesy of *Commodity Trend Service,* (800) 331-1069) shows the action of the Dec. German Bund contract over the last three months.





There's no question about it, investors have been using the D-mark and the Swiss franc as stores of value in place of gold. For this reason, many investors feel that gold will not really enter a major bull market until it starts to rise on a trend basis against the D-mark. Obviously, this has not happened yet (see chart).

Nevertheless, gold remains the only true money. Gold has no master, it does not represent any government's liability, it doesn't care about borders, and no one questions its intrinsic value.

Recently, rather surprisingly, Mr. Bush suggested that the world monetary system be tied to a basket of commodities including gold. This was quite an admission, although few people paid attention to it. I took it as an admission that that the dollar needs an anchor. The president couldn't admit that the anchor that was needed was gold, so he opted for a basket of commodities "including gold."

A currency linked with gold is the only currency which can hold its value over time. But a currency linked with gold exerts a discipline which frightens politicians. After all, you can inflate a fiat currency for years, and the people can't really tell what's happening. But when you inflate a currency that is linked to gold, the price of gold rises -- and everyone KNOWS what that means.

Inflation: The real problem the US economy has to deal with is this -- the nation isn't producing enough PROFITS to cover its mighty mountain of debts. The reaction to this problem by US business, so far, is to cut expenses, which basically means firing tens of thousands of workers. Unfortunately, that's NOT going to be enough.

There's only one way out of this mess. That way is to reduce the power of the debts. How do you do that? You do it with INFLATION. Make no mistake about it -- what the Fed has been trying to do with its 24 declines in interest rates is to RE-INFLATE THE US ECONOMY. Inflation, it's the political process of "gain without pain" (of course the "gain" is an illusion), it's the government's way of attacking the debt.

You doubt all the above? Then consider this: why with all the deflation that has taken place in commodities, housing, business, employment, etc. is gold still selling around 350? And why with 24 consecutive Fed interest rate cuts is the Treasury long bond still yielding a fairly fat 7.4%. The answer is obvious -- knowledgeable investors know that the US (as always) is opting for inflation to turn the economy around. The only way out of the current recession is via inflation. The markets know it. Every investor should damn well be aware of it.

Conclusion: The US is opting for inflation. Gold will rise when inflation becomes apparent. It's only a question of time.

Question: Russell, all well and good. But suppose the Fed can't induce inflation, then what?

Answer: Then the US will remain in a state of recession or worse, depression. It's "Inflate or die"; those are the two alternatives. And with all due respect to Ross Perot's deficit-reduction plans, there is no painless way to get us out of this predicament.

Question: How does all the above fit into a bear market scenario?

Answer: The bear market will reflect the move out of financial assets (stocks and bonds) and into tangible assets (accompanied by rising interest rates). That's if the government can generate inflation. If it can't, then the bear market will be about unsustainable debt swamping the nation.

LATE NOTES: There's been an incredible lack of comment or, for that matter, even recognition of the October 5 Dow Theory bear signal. I've been writing these Letters since 1958, and I've never seen anything like it. Is the situation too frightening to contemplate or is it just ignorance or complacency on the part of the analysts? Darned if I know, but as a rule, the less publicity on a signal, the more valid the signal . . . The VOLATILITY in the currencies is amazing. Swiss franc was up almost 7 cents in a matter of days, then a few weeks later down almost seven cents in a few days. It's unbelievable. If any commodity traders have made money trading the currencies over the past month, they deserve a medal. . . Bond market very toppy. Long rates now back to 7.5%. If rates start pushing above that level, the Fed will be sweating, and they'll feel pressure to cut rates again.

NEXT MAILING: Oct. 28, 1992